DECLARATION OF JOHN B. HAYES

MARKET POWER AND THE SBC-AMERITECH MERGER

14 October 1998

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I. INTRODUCTION AND QUALIFICATIONS

1. My name is John B. Hayes. I am a Senior Economist employed by The Tilden Group, a consulting firm that applies economic analysis to issues of antitrust and regulatory policy. My work as an economist has been in the area of microeconomics, with a specialization in the study of antitrust and regulatory policies. In the course of my professional career I have had numerous opportunities to consider questions of market definition in the context of mergers and acquisitions generally.

2. I was previously employed by the U. S. Department of Justice for five years. Most recently, I assisted in the Department's evaluations of the Ameritech and SBC applications to provide in-region long-distance services. I have also taught courses at Georgetown University and advised government officials in the United States and other countries on antitrust and telecommunications policy.

3. I earned a Ph.D. in Economics from the University of Wisconsin, where my major field of study was Industrial Organization. A copy of my curriculum vitae is attached to this declaration as Appendix A.

4. I have been asked by counsel for Sprint to determine the markets relevant to an analysis of the competitive effects arising from the proposed merger of SBC and Ameritech; to identify the participants, together with their shares, in those markets; and to assess the competitive significance of these market participants. In reaching my conclusions I have relied upon the SBC-Ameritech *Merger Application* [1] and affidavits offered in this proceeding, evidence submitted in state and federal section 271 proceedings, industry reports, previous Tilden Group analyses of telecommunications markets, and the relevant economic literature. Drawing on my

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[1] *Merger Application of SBC Communications Inc. and Ameritech Corporation*, Description of the Transaction, Public Interest Showing and Related Demonstrations, CC Docket. No. 98-141, filed July 24, 1998 ("*Merger Application*").

training and experience as an economist, and my review of the relevant facts available to me, I find that the proposed merger raises significant public interest concerns.

II. OVERVIEW OF FINDINGS

5. This merger raises several concerns regarding competition in markets for telecommunications services: (a) the loss of horizontal rivalry between actual and potential entrants; (b) the potential for exclusion of future local exchange and long distance rivals;[2] and (c) the loss of benchmarks used to guide regulatory decisions.[3] As the exercise of market power underlies each of these concerns, it is useful to determine the relevant markets and assess the competitive significance of the market participants to accurately evaluate the potential for harm to competition from the merger.

6. There is evidence to suggest that, absent the merger, Ameritech would have continued with its plans to enter SBC's territory. In the light of: (a) the market power possessed by SBC and Ameritech; and (b) the difficulties of entry into local exchange and access markets in the regions served by SBC and Ameritech, and particularly into residential and small business markets, such a loss of potential competition is a serious harm to the public interest.

7. SBC and Ameritech have separately, and will continue to possess after the merger, the ability and an incentive to delay competitors' entry into local exchange and access markets and to discriminate against competitors after they have entered.[4]

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2 Declaration of Dr. Michael L. Katz and Dr. Steven C. Salop, "Using a Big Footprint to Step on Competition," October 14, 1998.

3 Declaration of Dr. Joseph Farrell and Dr. Bridger Mitchell, "Benchmarking and the Effects of ILEC Mergers," October 14, 1998.

4 *In the Matter of Second Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana,* Affidavit

The potential for delay and discrimination is an especially serious concern for new interconnection arrangements that require cooperation from the incumbent. As the Federal Communications Commission ("the Commission") has recognized, the emerging market for broadband access to small business and residential customers will require new interconnection arrangements and additional cooperation from incumbents to enable competition.[5] Moreover, this need for cooperation will not soon end. CLECs will continue to rely on BOC facilities to serve local exchange and access markets for years to come.

8. The loss of benchmarks is a significant public interest concern because, as detailed below, SBC and Ameritech in particular, and incumbent local exchange carriers in general, will continue to possess market power that will require on-going regulatory oversight. In addition, the loss of benchmarks will impair the Commission's ability to establish and enforce those rules necessary to enable and maintain competition in telecommunications services.

9. My review of the evidence leads to the following principal results and conclusions:

- The product markets relevant to an analysis of the competitive effects of the proposed merger are the local exchange and access markets. There are three customer segments in these product markets with distinct demand characteristics: large business customers, medium-sized business customers, and small business and residential customers. The competitive effects of the proposed merger should be separately studied in each of these segments. The geographic markets relevant to an analysis of the proposed merger are the local service areas within the regions served by SBC and Ameritech.

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of Marius Schwartz on Behalf of the U.S. Department of Justice, CC Docket 98-121 at ¶¶99-107.

5 *In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capabilities*, Memorandum Opinion and Order and Notice of Proposed Rulemaking, FCC 98-188, released August 7, 1998 at ¶19.

- While the market share data are incomplete, there is persuasive evidence that local exchange and access markets are highly concentrated for all customer segments and in virtually all geographic markets. Large business customers located in major metropolitan areas are more likely than others to have viable competitive alternatives for service, but even for these large customers choice is limited. Small business and residential customers, with few exceptions, have no alternative service provider available. Aggregating across customer segments and geographic markets, the market share served by competitors to SBC and Ameritech never exceeds five percent.
- SBC and Ameritech possess substantial market power in many local exchange and access markets, and they will continue to possess market power for years to come. Further, competitors and providers of complementary services, such as long distance and mobile wireless services, will continue to require cooperation from the incumbent, both for existing services and for new and innovative forms of telecommunications.
- Even if the "National-Local" entry strategy described in the *Merger Application* is enabled by the merger, it will initially bring competition only to those large and medium-sized business segments of the local exchange and access services markets that are currently experiencing competitive entry. Thus the National-Local strategy appears unlikely to significantly benefit small business and residential customers in the short term. Furthermore, the long term benefits to competition in this under served market segment are uncertain.
- The merger of SBC and Ameritech does not meet the Commission's public interest standard that the merger will enhance competition.[6]

10. In the remainder of this declaration, I explain in detail the economic logic, factual analyses, and supporting data that have led me to the findings summarized above.

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[6] *In the Applications of NYNEX Corporation Transferor, and Bell Atlantic Corporation Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, Memorandum Opinion and Order, FCC 97-286, released August 14, 1997 ("*Bell Atlantic-Nynex Order*") at ¶¶2-3.

III. RELEVANT MARKETS FOR PUBLIC INTEREST ANALYSIS

A. Principles of Market Definition

11. In assessing whether a carrier has market power, and whether a merger is likely to harm competition, it is helpful to define relevant markets. Economists generally define market power as the ability to maintain prices above competitive levels for a sustained period of time.[7] Properly defined markets are a useful tool for assessing the competitive effects of mergers and other business practices.

12. Relevant markets are usefully defined along two dimensions: (1) the collection of products or services to be included in the market; and (2) the geographic scope of the market. Within each dimension, economists determine the scope of a relevant market by the existence of demand substitutes.[8] Those products that consumers view as good substitutes are properly included within the market. Products that consumers perceive as poor substitutes are excluded from the market. The Commission adopted this approach in the *LEC In-Region Interexchange Order* and the *Bell Atlantic-Nynex Order.*[9] In a correctly defined market, a hypothetical monopoly producer of all of the products or services included in the market could profitably raise price(s) above competitive levels for a sustained period of time. In contrast, any market in which a monopoly producer could not sustain a price increase would not be a useful tool for assessing the possible exercise of market power following a merger.

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7 Alternatively, one could define market power as the ability to maintain quantity or quality below competitive levels for a sustained period of time.

8 U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines,* April 2, 1992 (revised April 8, 1997).

9 *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area,* Second Report and Order, FCC 97-142, released April 18, 1997 ("*LEC In-Region Interexchange Order*") at ¶27 and *Bell Atlantic Nynex Order* at 50.

B. Relevant Product and Geographic Markets

13. SBC and Ameritech provide a diverse and expanding array of telecommunications products and services. These products and services are usefully grouped into two categories. Retail services, such as Centrex and basic local service, are provided in downstream markets to end users. Wholesale services, such as access and the provision of unbundled network elements, are provided in upstream product markets to other network providers. At both the wholesale and retail levels, many of these services could potentially be considered distinct relevant markets.[10] In this declaration I focus on the provision of two core services—basic local exchange service and access—that are fundamental to many, if not most, of the network services provided by the merging parties. Competitive conditions in these markets are likely to be similar to those in other markets relevant to an analysis of the competitive effects of the merger.

14. An ability to complete calls ubiquitously over the public switched network is an essential characteristic of telecommunications. Access services provided by ILECs are fundamental to this ability, as they allow carriers to complete calls on distant and disparate networks. Access services can take many forms.[11] Horizontal access arrangements allow competitors to interconnect their network with the incumbent's local exchange network. Vertical access arrangements permit providers of complementary services, such as long distance or wireless services, to originate and terminate calls on the local network. In this declaration I will use the term access expansively to refer to all forms of access to the local exchange network in a specific

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[10] Long distance services may be an additional relevant market. As SBC and Ameritech are new and comparatively small participants in long distance services, I have not addressed long distance services in this declaration. For similar reasons, I have not addressed bundled long distance and local services.

[11] See Ingo Vogelsang and Bridger M. Mitchell, *Telecommunications Competition: The Last Ten Miles*, MIT Press, 1997 at 12-17.

local service area.[12] As there are no viable substitutes to access, this service is a relevant market.[13]

15. Local telephone service, broadly defined, is a collection of services that includes the capabilities (1) to originate calls from a specific location and terminate them anywhere on the public switched telephone network, and (2) to receive calls from any point on the public network. As a practical matter, there are no viable substitutes for local service, and therefore this product constitutes a relevant market.

16. There are many specific locations to originate calls within local telephone networks and consequently, there are many distinct relevant product markets within a local service region. It is also true, however, that within any particular geographic region there is a limited set of carriers that have facilities in place to provide local telephone service. Within this region, the range of competitive alternatives and, more importantly, the nature of competition between the alternative suppliers, may be very similar. It can be useful in such circumstances to aggregate these similar product markets and assess competition in the aggregate market as a whole. Because consumers face the same set of choices within this area, the competitive effects of the merger can be accurately analyzed within the aggregate market.[14]

17. For many telecommunications markets, such aggregation may be more than a convenient way to simplify the analysis. When competition takes place simultaneously over multiple markets, it is often useful to gauge the competitive

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12 It is worth noting that this definition does not encompass special access arrangements that provide access to interexchange networks but do not directly provide access to a local exchange network.

13 More narrowly defined access markets may also exist. The competitive effects of the merger in more narrowly defined markets are unlikely to differ substantially from those identified in this broadly defined market.

14 See the *Bell Atlantic-Nynex Order* at ¶51 and the *LEC In-Region Interexchange Order* at ¶5.

significance of market participants in an aggregate market that encompasses the full set of markets where firms simultaneously compete. Residential and small business telecommunications services in particular are marketed through mass media outlets which reach potential customers spanning large areas. The economies of scale inherent in this kind of marketing compel competitors to provide service to the entire area addressed by their marketing efforts. As a consequence supply conditions, especially those in the residential and small business customer segment, provide an additional reason to assess competition within aggregate local service markets.

18. SBC and Ameritech provide local telephone service to customers in certain well-defined geographic areas. The competitive alternatives for service available to customers in these local service areas are generally sufficiently similar to treat each local service area as a separate relevant market.

19. An alternative approach to defining a local service market begins with the observation that telephone calls are point-to-point (or in some cases point-to-multipoint) connections, so one could potentially think about each call from a specific origination point to a specific termination point as a unique product.[15] As there are no viable substitutes for specific point-to-point telephone connections—a call from the office to home cannot substitute for a call from the office to a client—each point-to-point connection constitutes a distinct relevant market.[16]

20. Taking point-to-point calls as a product therefore leads once again to the conclusion that there are many distinct relevant product markets. For the same

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[15] The Commission has taken this approach in several recent decisions. See the *Bell Atlantic-Nynex Order* at ¶51 and ¶54 and the *LEC In-Region Interexchange Order* at ¶5.

[16] Defining local service markets around point-to-point calls suffers from the defect that local service is not typically sold on a point-to-point basis. Instead, local service is sold in a bundle that includes a general ability to terminate calls to any point on the local network. This fact indicates that it may not be economically viable to offer local service on a point-to-point basis.

reasons described above, however, it is both convenient and analytically useful to aggregate those markets where the competitive alternatives are similar. Such an aggregation leads to the same set of local service areas identified above.

21. The two alternative approaches to market definition for local exchange services described in this section lead to an identical collection of relevant markets for an assessment of the competitive effects of the merger: the local service areas in SBC's and Ameritech's service regions. Economic analysis of the merger is unaffected by a decision to adopt one approach to market definition over the other.

C. Market Segments

22. It is widely accepted that the patterns of demand for some customer groups are sufficiently distinct that they require separate analysis. The Commission has previously determined that within local exchange and access services markets it is possible to identify three customer groups with distinct patterns of demand: (1) residential and small business customers, (2) medium-sized business customers, and (3) large business and government customers.[17] These groups are distinguished by the different characteristics of their demands for local exchange and access services.

23. The large business and government customer segment consists of customers who typically:

- generate traffic volumes that require multiple high-capacity lines (*e.g.*, DS1s and DS3s) for their local exchange and access services;
- purchase a wide array of complex telecommunications services such as ISDN, frame relay and Centrex;
- negotiate firm-specific contracts;
- have dedicated, professional telecommunications services managers on staff; and
- require a premises visit to initiate service.

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[17] *Bell Atlantic-Nynex Order* at ¶53.

In contrast, residential and small business customers typically:

- generate traffic volumes that can be supported by one or two voice grade lines;
- purchase local service together with vertical features such as call waiting or caller ID; and
- rarely require a premises visit to initiate service.

The demand patterns for medium-sized business customers are intermediate between those of large business customers and residential and small business customers. Medium-sized business customers typically generate traffic volumes that require multiple voice-grade lines but not multiple high-capacity lines.

24. Reflecting the complexity and scale of their purchases, local telephone service for large business and government customers is generally marketed through dedicated account representatives who visit the customer's premises to describe service offerings. In contrast, service is marketed to residential and small business through mass media and to medium-sized business customers by specialized firms.

25. Consistent with their high traffic volumes and demand for complex telecommunications services, local service revenues are concentrated in large business customers. The largest one percent of local service customers account for roughly 30 percent of revenues.[18] Business customers of all types utilize 32 percent of switched access lines nationwide; residential customers account for 67 percent of all access lines; and pay telephones account for one percent.[19]

26. These three customer segments exhibit sufficiently different demand patterns that the competitive effects of the merger should be separately assessed for each

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[18] Vogelsang and Mitchell *op. cit.* at 29, citing *Bypass of the Public Switched Network*, Third Report and Order, released May 26, 1987 at 32.

[19] *1997 Preliminary Statistics of Common Carriers*, Federal Communications Commission, ("*1997 Preliminary SOCC*") Table 2.5.

market segment. Large, and to a lesser extent medium-sized, business customers are most readily served by CLECs because their traffic volumes profitably support the provision of multiple access lines.[20] As a result the competitive effects of the merger could differ significantly across the three customer segments.

IV. SBC AND AMERITECH POSSESS *DE FACTO* MONOPOLIES IN LOCAL EXCHANGE AND ACCESS MARKETS

A. Methodology for Assessing Market Power

27. The courts have long recognized that market share is an important predictor of an ability to exercise market power. In addition to market share, however, one must also consider other measures of structural characteristics of the relevant markets, indicators of market performance, and entry conditions.

B. SBC and Ameritech Dominate Their Local Exchange and Access Markets

28. While the data available to assess market structure in the relevant markets are limited, they provide persuasive evidence that SBC and Ameritech have dominant shares of local exchange and access markets in each customer segment. Moreover, because CLECs must interconnect with the incumbent carrier, their ability to discipline efforts to exercise market power is to a considerable extent controlled by the incumbent. As there are no viable substitutes for local exchange and access services, SBC and Ameritech could substantially raise prices or degrade the service they provide to competitors, unless they are prevented from doing so by regulation.

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[20] The competitive effects for small business customers may, in fact, differ sufficiently from residential customers that it also would be useful to separately assess effects in this customer segment. Residential service generally is priced at lower rate than business service. This pricing difference could potentially support greater entry opportunities for CLECs in the small business segment than in the residential segment, even if traffic volumes for these two customer groups are comparable.

29. That the ILECs possess substantial market power is hardly news. The Commission previously has found this to be true on numerous occasions.[21] Both the Commission and state regulators cap access charges for precisely this reason.[22] Moreover, the interconnection and structural separation provisions of the Telecommunications Act of 1996[23] also are based on recognition of ILEC market power.[24] In this declaration, I provide some evidence on the extent of the market power possessed by SBC and Ameritech. Several alternative measures of market structure are examined, including:

- shares of switched access lines;
- shares of switched minutes of use; and
- the existence of local service facilities, including collocation facilities and fiber facilities.

30. My analysis concentrates on switched facilities because switched lines provide both local exchange and access services. Shares of switched lines are therefore a useful indicator of market structure in both local exchange and access markets.[25] As

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21 See, for example, *In the Matter of Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, Notice of Proposed Rulemaking, CC Docket No. 95-185, released January 11, 1996 ("*LEC-CMRS Interconnection Proceeding*") at ¶2. "LECs unquestionably still possess substantial market power in the provision of local telecommunications services."

22 See *In the Matter of Access Charge Reform*, First Report and Order, released May 16, 1997 at ¶¶258-284.

23 Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996). The 1996 Act amends the Communications Act of 1934, 47 U.S.C. §§ 151 et. seq.

24 See *In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, Notice of Proposed Rulemaking, CC Docket No. 96-149, released July 18, 1996 at ¶3 and *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, Notice of Proposed Rulemaking, CC Docket No. 96-98, released April 19, 1996 at ¶¶6-10.

25 Shares of switched access lines may not provide a useful measure of market structure for exchange access services provided to certain high-volume customers. Some high-volume

the Commission has observed, "[B]ecause interstate switched access is generally provided over the same 'bottleneck' facilities and by the same providers as provide local exchange and exchange access service, failure to create competition among local service providers necessarily means a lack of competition to provide interstate switched access."[26]

31. The publicly available data have several deficiencies. Most importantly, the data are not available by customer segment or local service area. My conclusions are therefore based on an examination of state-level data reported separately for business and residential customers.

i. Switched Access Lines

32. There are sufficient data to estimate market shares based on switched access lines in four states within the service areas of the merging parties. Within the states of California, Oklahoma, Arkansas and Michigan, CLECs have a 4.9 percent share of the switched access lines provided to business customers, and they have a two percent share of the residential lines. Combining the business and residential categories, CLECs on average have a 3.2 percent share of switched access lines. Data for each state are provided separately in Table 1.

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customers, such as large businesses, can purchase dedicated, special access lines. There is evidence that CLECs have a greater share of special access lines than switched access lines. This is the case both because CLECs have been selling special access longer than switched access, and more importantly, because special access lines are installed at locations that have sufficient traffic volumes to support multiple high-capacity access lines. Consequently, customers who purchase special access are precisely the customers that are most readily served by CLECs. Special access lines account for 16 percent of total access lines and 19 percent of total interstate access revenues. *1997 Preliminary SOCC*, Tables 2.5 and 2.9.

26 *Bell Atlantic-Nynex Order* at ¶31.

TABLE 1. ILEC MARKET SHARE OF LOCAL EXCHANGE LINES

STATE	CLEC FACILITIES-BASED LINES (On-net + UNE Loops)		CLEC RESALE LINES		TOTAL ILEC LINES		ILEC MARKET SHARE		
	Residential	*Business*	*Residential*	*Business*	*Residential*	*Business*	*Residential*	*Business*	*Combined*
AR	99	9,584	7,162	1,164	641,395	293,116	98.88%	96.46%	98.11%
CA	9,050	247,873	144,786	106,987	10,318,000	6,831,000	98.53%	95.06%	97.12%
MI	18,293	65,685	154,660	32,807	3,245,840	1,918,863	94.94%	95.12%	95.01%
OK	68	6,300	7,232	1,662	1,099,211	511,230	99.34%	98.47%	99.06%
Weighted Average ILEC Market Share (weighted by lines)							**97.84%**	**95.34%**	**96.83%**

Source: See Appendix B.

33. These estimates are based on data from a variety of sources including evidence filed in state and federal 271 proceedings and the *Local Competition Survey*.[27] The figures include CLEC customers served through resale, through UNE loops and those served entirely on CLEC facilities.[28]

34. These estimates are comparable to those from industry analysts. Paine Webber, for example, estimates that nationwide CLECs have 7.1 percent of business lines, 2.1 percent of residential lines and 3.8 percent of all lines.[29]

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27 *FCC Survey on the State of Local Competition*, DA 98-839, March 1998 (data as of December 31, 1997) ("*Local Competition Survey*").

28 The CLEC resale data for Michigan reported in the survey contain substantially more resale lines than Ameritech reported in its application to provide in-region, interLATA service in Michigan. In that application, Ameritech reported 4,313 resale lines, excluding resold Centrex lines, as of March 1997. *In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan*, CC Docket 97-137, Joint Affidavit of Robert G. Harris and David Teece On Behalf of Ameritech Michigan ("*Harris-Teece Michigan Affidavit*") Table III.1. However, in the *Local Competition Survey* Ameritech reported 187,467 resale lines, including Centrex lines, as of December 31, 1997.

29 E. Struminger et al., "Telecommunications Services: Local Exchange-Industry Report," Paine Webber, July 30, 1997 at 17-18 (Tables 6 & 7).

ii. Minutes of Use

35. There are sufficient publicly available data, for some of the states directly affected by the merger, to estimate the share of switched local service minutes carried by CLECs operating in BOC service areas.[30] Table 2 contains market shares of switched local service minutes[31] for the Ameritech states and California.[32] The table shows that Ameritech's share ranges from 96.9 percent, in Illinois, to nearly 100 percent, in Indiana.

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30 By definition, the CLEC share of minutes is equal to the number of minutes that originate or terminate on CLEC networks divided by the total number of minutes that originate or terminate in the BOC service area. I have estimated the CLEC share by dividing the number of minutes CLECs exchange with the BOC by the total number of minutes that originate or terminate on the BOC's network. This estimate necessarily understates actual CLEC shares of total local exchange and access minutes of use because it does not include, in either the numerator or the denominator, minutes for calls that travel entirely on CLEC networks. As these calls are unquestionably a tiny fraction of the total, this source of bias is small.

31 The *Local Competition Survey* data includes local, intrastate and interstate switched minutes. As the BOCs are prohibited from carrying interLATA minutes, the latter two categories are largely switched access minutes.

32 SBC also provided minutes-of-use data for the *Local Competition Survey*. However, SBC appears to have reported ILEC minutes in a significantly different manner than Ameritech and Pacific Telesis. Because the SBC data do not appear to be comparable, they are not included here.

TABLE 2. ILEC MARKET SHARE OF NETWORK MINUTES OF USE

STATE	ILEC MINUTES	MINUTES EXCHANGED WITH CLECS	DISTRIBUTION OF CLEC MINUTES		ILEC MARKET SHARE
			Originating on ILEC Network	*Terminating on ILEC Network*	
CA	74,013,471,052	500,174,079	77.6%	22.4%	99.33%
IL	32,896,492,720	1,050,833,669	94.2%	5.8%	96.90%
IN	11,967,897,384	3,737,297	0.0%	100.0%	99.97%
MI	26,319,493,819	604,284,763	88.9%	11.1%	97.76%
OH	22,805,309,356	316,802,505	98.6%	1.4%	98.63%
WI	10,774,196,646	88,332,324	94.6%	5.4%	99.19%
Weighted Average ILEC Market Share (weighted by minutes)					**98.59%**

Source: *Local Competition Survey*. Data as of December 31, 1997.

36. Table 2 also contains data on the distribution of minutes exchanged over trunks connecting CLEC and BOC networks. Inspection of these interconnection data reveals that the minutes exchanged across BOC and CLEC networks are notably unbalanced. Table 2 shows that CLECs originate far fewer minutes to BOC networks than they terminate from the incumbent's network. These data suggest that CLECs have been most successful at selling service to customers, such as Internet service providers, that terminate far more calls than they originate.[33]

37. The unbalanced origination and termination minutes exchanged between ILEC and CLEC networks suggest that CLEC sales are concentrated in a limited market segment, an inference which provides a reason to be cautious about predicting CLEC success in a broader local service market. Additional analysis is needed to understand why CLECs have been especially successful in this market

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[33] Bell Atlantic recently argued that Internet service providers operating on CLEC networks are driving the traffic imbalance. Letter from Edward D. Young, III, Senior Vice President and Deputy General Counsel, and Thomas J. Tauke, Senior Vice President for Government Relations, on behalf of Bell Atlantic, to William E. Kennard, Chairman, Federal Communications Commission, dated July 1, 1998.

segment. Specifically, it is unclear whether the competitive advantages that CLECs possess in this segment are sustainable over time and will prove valuable in the broader market.

38. For example, CLEC success with Internet service providers may be partly explained by reciprocal transport and termination rates that are in excess of cost. If these rates are set above cost, then CLECs have an incentive to seek customers that terminate more calls than they originate. CLECs could offer such customers unusually attractive service rates because, net of reciprocal compensation payments to the BOC, they earn rents on call termination services sold to the ILEC. This type of competitive advantage would not extend to customers with balanced calling patterns because these customers would not provide transport and termination rents to the CLEC. Moreover, this type of advantage is not sustainable because it is not based on an inherent cost or other advantage possessed by CLECs.[34]

iii. Local Exchange Facilities

39. Because it is doubtful that resale will create sufficient competitive pressure to significantly discipline BOC market power, it is useful to separately assess the shares of CLECs that are providing facilities-based local service. While offering valuable competition over some aspects of service, such as marketing, billing, and customer service, resale is of inherently limited competitive significance and is therefore less meaningful as a constraint upon the exercise of market power than facilities-based service. Facilities-based CLECs can offer additional competition along a number of dimensions, such as service innovation and network quality, where the capabilities of

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[34] It is ironic that the BOCs are now working to limit their transport and termination payments to CLECs, after they opposed Bill and Keep arrangements in the CMRS interconnection proceeding. *LEC-CMRS Interconnection Proceeding* at 38. Wireless carriers tend to originate more calls than they terminate. Thus interconnection with wireless carriers at transport and termination rates set above cost would tend to generate net rents for the BOCs.

resellers are limited. Because resale rates are not based on the underlying costs of the facilities, resale competition can do relatively little to drive retail rates down towards cost.[35] Facilities-based competitors also represent alternative sources of access services, while resellers do not serve this function.

40. Facilities-based competition also is superior to resale competition because it represents far greater competitor independence of the ILEC. For the purposes of competitive assessment, a key issue is whether one firm is dependent upon its *competitors* for key inputs. Clearly, CLECs who are reselling BOC service remain heavily dependent upon the BOC to provide service, contractual and regulatory protections notwithstanding. In its merger analyses, the U.S. Department of Justice routinely recognizes in merger analysis that firms dependent upon rivals for key inputs (*e.g.*, through a supply agreement designed to fix an anticompetitive outcome associated with an acquisition) typically are not as strong a competitive force as those that operate independently. Competition from firms that rely upon a rival for a key input, and whose basic ability to offer services is dependent upon contractual rights unwillingly imposed on a direct rival, are generally not "economically equivalent" to fully independent rivals. Of course, all CLECs, including facilities-based CLECs, are dependent on ILECs for interconnection services.

41. Looking only at facilities-based service, the data show that CLECs serve only a tiny fraction of total switched access lines. Table 3 details the CLEC share of facilities-based lines to business and residential customers in California, Oklahoma, Arkansas and Michigan, the only states for which there are sufficient publicly available data to calculate shares. These data include access lines purchased as

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[35] Harris and Teece, in an affidavit on behalf of Ameritech Michigan, appear to agree with this, stating that "for purposes of competitive assessment, self-supplied facilities and leased unbundled network elements...are clearly distinct from resale of services over the incumbent's facilities." *Harris-Teece Michigan Affidavit* at 15.

unbundled loops from the BOC. The CLEC share of facilities-based service to business customers ranges from 1.2 percent in Oklahoma to 3.5 percent in California. In comparison, facilities-based service to residential customers is *de minimus*. The CLEC share of facilities-based service to residential customers does not exceed one percent for any of the states shown in Table 3.

TABLE 3. CLEC FACILITIES-BASED MARKET SHARE OF LINES

STATE	CLEC FACILITIES-BASED MARKET SHARE		
	Residential	*Business*	*Combined*
AR	0.02%	3.15%	1.02%
CA	0.09%	3.45%	1.46%
MI	0.54%	3.26%	1.54%
OK	0.01%	1.21%	0.39%
Market Share (weighted by total lines)	**0.18%**	**3.29%**	**1.39%**

Source: See Appendix B.

C. The Competitive Landscape for Business and Residential Customers

42. The market share data presented in Tables 1 and 3 indicate that there are significant differences in the competitive alternatives available to business and residential customers. Residential customers are far less likely to have competitive alternatives to SBC and Ameritech than are business customers. In large part, the data reflect the relative attractiveness to CLECs of the various market segments. Bernie Ebbers, WorldCom's Chairman and CEO, has stated that "Not AT&T, not MFS or anyone else, is going to build local telephone facilities to residential

customers. Nobody ever will in my opinion."[36] The evidence on CLEC business plans and facilities locations examined in this section confirms that while competition for business customers is developing, there are limited prospects for competition to provide local service to residential customers. In the last part of this section I evaluate the likely impact of the National-Local strategy announced by SBC and Ameritech on competitive conditions in local exchange and access markets.

i. Competition for Large Business Customers in Major Urban Centers

43. The announced business plans and actual marketing efforts of CLECs indicate that most entrants into local exchange and access services markets are principally interested in attracting business, as opposed to residential, customers. CLEC strategies largely concentrate on service to high-volume business customers located in major urban centers. With few exceptions, most CLECs have no plans to offer residential service in the near term.[37]

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36 Mike Mills, "Hanging Up on Competition?," *Washington Post,* June 1, 1997 at H1.

37 See "CLEC Officials, Wall Street Predict Continued Growth, But Not in Local Residential Market," *Communications Today,* November 4, 1997. RCN offers resold residential service in the Washington D.C. area and has announced plans to build network facilities to serve residential customers in the region. See Martha M. Hamilton, "The Power to Link Masses? PEPCO Venture to Offer Phone, Cable, Online Service," *Washington Post,* May 22, 1998 at D1. See also "RCN Doubles On-net Homes Passed: Advanced Fiber Connections up More than 135%," *RCN Press Release,* July 22, 1998 (available at www.rcn.com). Cablevision offers facilities-based residential service in Long Island, New York. See www.cablevision.com/cvhome/frame/fphone.htm. Brooks Fiber/Worldcom has entered the residential local exchange and access services market on a facilities basis in Michigan, but it has not expanded its residential service outside that state. *Communications Today, op. cit.* See also *In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan,* Memorandum Opinion and Order, FCC 97-298, released August 19, 1997 ("*Ameritech Michigan Order*") at ¶65. It is too early to tell whether WorldCom will continue to pursue this strategy.

44. The evidence presented in this application clearly shows that CLEC facilities are concentrated in the major urban areas of each state.[38] For example, most CLEC facilities in Illinois are located in the greater Chicago area. Only two of the 16 companies offering or planning to offer facilities-based service in Illinois that SBC describes in its merger application have facilities outside of the Chicago metropolitan area, and those carriers also serve areas with an especially high demand for telephone services.[39]

45. Although the CLECs' current business plans generally do not include service to residential customers, some CLEC facilities potentially could be used to provide residential service in the future. For example, Harris and Teece report that as of July 1997, CLECs were collocated in only 9 percent of Ameritech Michigan's end offices.[40] However, those end offices serve 42 percent of Ameritech's business access lines and 29 percent of its residential lines, which together account for 32 percent of Ameritech Michigan's revenues. Thus the existing CLEC collocation facilities in Michigan potentially could support local exchange and access services to significant numbers of residential customers, if local markets are sufficiently open to competitors and if such service is profitable.

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38 *Merger Application* at Tables 11 & 12.

39 Consolidated Communications is an independent LEC that has been serving Ameritech customers located near its Mattoon service area over unbundled loops purchased from Ameritech. Consolidated uses capacity on switches located in its in-region service area to complete calls. Consolidated provides residential service in Champaign, Decatur, Peoria, and Springfield. Springfield is the state capitol of Illinois and Champaign/Urbana is the main campus of the University of Illinois. Consolidated merged with McLeodUSA in June 1997. QST Communications also provides facilities-based service to Peoria and plans to serve Bartonville, Pekin, and Springfield in the future. See New Paradigm Resources Group, Inc. and Connecticut Research, Inc., *1998 CLEC Report*, 9th Edition, 4th Printing, 1998 at Chapter 9.

40 *Harris-Teece Michigan Affidavit*, Table III.2.

ii. Residential and Small Business Customers Lack Competitive Alternatives

46. At the present time, there is only a limited potential for profitable entry into the residential and small business segment of local exchange and access markets. The major long-distance companies have scaled back or frozen their initially-ambitious plans to enter local markets, citing poor profitability.[41] Cable companies have also pulled back on their highly-touted plans,[42] and industry analysts have asserted that "there is no business case for cable telephony."[43] Dan Miller, chairman of the Illinois Commerce Commission, explains the current limited competition for residential

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41 In January of this year, MCI President Timothy Price announced that "as long as the current regulatory environment continues, MCI will not offer resale service to any new residential customers." See January 22, 1998 MCI Press release, available at http://www.mci.com. This was soon followed by an announcement from AT&T's chairman Michael Armstrong that "the company has halted its efforts on the total services resale (TSR) method of local service entry but will continue to support its current local customers....TSR discounts are not big enough to make it an economically viable way for AT&T to provide local service." See AT&T Press release, January 26, 1998, available at http://www.att.com. AT&T claims to be losing $3 a month per local telephone customer. "AT&T Says It Loses Money on Local Telephone Service," *St. Louis Post-Dispatch*, February 11, 1998. AT&T apparently is still working on its wireless local service plans.

42 TCI, for example dropped its cable telephony plans. See "TCI Drops Telephony Bombshell," Cable Business International, January 1997 at 31; Mark Robichaux, "Bad Call: Malone Says TCI Push into Phones, Internet Isn't Working for Now," *Wall Street Journal*, January 2, 1997 at A1; and Jon Van, "TCI's Cable Phone on Hold," *Chicago Tribune*, August 26, 1998, at B1. Time Warner also suspended its cable telephony plans. See Stephan Somogyi, "Sages or Stooges?," Upside, June 1997 9(6) at 62-68. It is too early to tell whether the proposed AT&T-TCI merger will reinvigorate efforts to offer telephony over cable TV plant. See Leslie Cauley, "TCI, AT&T Look to Enter Partnerships With Cable-TV Firms on Phone Service," *Wall Street Journal*, September 24, 1998 at B14.

43 David Roddy, chief telecommunications economist at Deloitte and Touche Consulting Group in Atlanta, as quoted in Stephan Somogyi, "Sages or Stooges?," *Upside*, June 1997 9(6) at 62-68. A report prepared for MCI by Hatfield Associates found that even with optimistic assumptions regarding network development costs, operating costs, market penetration and revenue growth, the business case for cable telephony in the short run is weak. "The Enduring Local Bottleneck II," Hatfield Associates, Inc., April 30, 1997 at 41-43.

customers by observing: "What nitwit is going to go in and start competing where the prices don't cover the cost?"[44]

47. Mobile wireless service also is not currently a practical economic alternative to wireline local exchange and access service for the vast majority of customers. Mobile wireless service generally is not priced competitively with basic wireline service for a consumer with a high volume of calling from a fixed site to nearby end users.[45] To date, mobile wireless service has been further limited in its ability to substitute for basic telephone service by its relatively low data transmission rates, lower voice quality, and the fact that wireless customers pay for both incoming and outgoing calls. I am optimistic that wireless service will eventually compete with wireline service for a significant number of local exchange customers. The steadily decreasing prices, rapid network build-outs, and increasing penetration rates all speak to that possibility. But the fact remains that wireless service does not provide meaningful competition to wireline local exchange and access services at this time.

iii. The National-Local Strategy Will Not Expand the Competitive Alternatives Available to Residential Customers in the Near Future

48. SBC's National-Local strategy calls for SBC to expand into thirty of the largest MSAs outside the combined SBC-Ameritech service area.[46] SBC plans to launch service in each new MSA by serving the branch offices of large business customers that are headquartered in its existing service area.[47] It will then expand from these

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44 As quoted by Jerri Stroud in "Competition is Key to Phone Deal's Approval," *St. Louis Post-Dispatch*, May 17, 1998.

45 See *In the Matter of Second Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana*, Declaration of Carl Shapiro and John Hayes on Behalf of Sprint, CC Docket No. 98-121, filed August 4, 1998.

46 Affidavit of James S. Kahan ("Kahan Affidavit"), July 20, 1998 at 27.

47 *Id.* at 40-1.

initial customers to other large and medium-sized businesses.[48] In addition, SBC claims that eventually it will use the infrastructure created to serve these large and medium-sized business customers to provide service to residential and small business customers.[49]

49. If, through pursuing the National-Local entry strategy, SBC and Ameritech aggressively entered residential local exchange and access markets, the benefits to consumers could be substantial. There is little reason, however, to suppose that this upbeat outcome is likely in the near term. SBC and Ameritech have not explained how, after establishing service to the Fortune 500 companies that are the plan's initial service target, they will be able to profitably serve residential and small business customers. Indeed, the strategy that SBC and Ameritech have presented in this proceeding bears considerable resemblance to the strategies followed by facilities-based CLECs like MFS, TCG and MCI Metro, and none of these carriers have found it profitable to enter residential markets on a significant scale. SBC and Ameritech have not provided evidence to demonstrate why the National-Local strategy would allow them to succeed where others have foundered.

50. SBC and Ameritech further claim that their successful pursuit of the National-Local strategy will prod other ILECs to pursue out-of-region local exchange and access entry strategies of their own, thereby stimulating additional local service competition. Once again, SBC and Ameritech have provided no reason to expect the National-Local strategy to stimulate ILEC entry plans when the existing CLEC entry has failed to do so.

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48 *Id.* at 55.

49 *Id.* at 56.

D. Entry is Unlikely to Diminish BOC Market Power or Eliminate the Need for On-Going Regulation in the Near Future

i. Local Telephone Markets are Not Yet Open to Competition

51. Despite their claims to the contrary, SBC and Ameritech have not yet sufficiently opened their local telephone markets to competition. The Commission itself found serious deficiencies in Ameritech's Michigan application and SBC's Oklahoma application.[50] Moreover, state commissions in Arkansas, Texas, California, and Illinois also found that SBC and Ameritech had not met their obligations under the Telecommunications Act to open their local service markets to competition.

- In its recently-issued final staff report, the California Public Utilities Commission stated: "Pacific's OSS offering needs fundamental changes to bring it into compliance with Section 271." It found that the company had complied with only four of the 14 checklist items and used the following harsh words to describe competition in California: "Local competition is floundering at the present time: the resale market is moribund with only a handful of new orders coming in. The so called 'UNE platform,' in which a competitor provides service using combinations of unbundled elements, is not yet a viable method of entry. At the present time, it is almost impossible for a residential customer to find an alternative carrier, unless that customer lives in one of the few areas around the state where cable companies are offering telephone service to their cable customers."[51]
- In its recommendation to the FCC, the Texas Public Utility Commission stated that "if the Commission were asked to give a recommendation to the FCC today, it regrettably would be required on the record before it to say 'not yet.'" Among other things, the Commission criticized the electronic flow through of SBC's

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50 *Ameritech Michigan Order* and *Application by SBC Communications, Inc., Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Oklahoma*, Memorandum Opinion and Order, CC Docket No. 97-121, released June 26, 1997.

51 *Pacific Bell (U 1001 C) and Pacific Bell Communications Notice of Intent to File Section 271 Application for InterLATA Authority in California*, California Public Utilities Commission Telecommunications Division Final Staff Report, October 5, 1998 at 10, 13.

LEX and EDI systems, saying it was "not sufficiently comparable to that of SWBT's EASE system to provide nondiscriminatory access to CLECs."[52]

- The Illinois Commerce Commission likewise concluded that "Ameritech has not met the Section 271(c) requirements for BOC entry into the in-region interLATA services market." It specifically cites items pertaining to network elements (OSS), unbundled local transport and switching, and resale.[53]
- A report of the Arkansas Public Service Commission states that "with the exception of higher priced residential service...residential service offerings from CLECs is [sic] almost nonexistent in Arkansas." During the Arkansas proceedings, SBC conceded that the time intervals under which it provides UNEs to CLECs do not allow CLECs to comply with the Arkansas PSC's quality of service standards for telecommunications providers. SBC takes 7-12 days to fill CLEC requests for UNEs; CLECs are required by the Commission's quality of service rules to provide their customers with service within five days.[54]

52. It is significant that these state commissions found that neither SBC nor Ameritech currently satisfies the section 271 standard. Section 271 does not require that BOCs face effective competition before interLATA authority is granted. It instead requires only that local service markets be opened to competition. Successful 271 applicants can, and they almost certainly will, retain substantial market power in local exchange and access markets even when interLATA authority is granted. These state commission rulings show that local exchange and access markets in SBC's and

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52 *Investigation of Southwestern Bell Telephone Company's Entry into the Texas Interlata Telecommunications Market*, Public Utility Commission of Texas, Commission Recommendation, PUC Project No. 16521, May 21, 1998 at 1, 8. LEX (Local Service Request Exchange System) is an interim solution for resale and UNE orders. EASE (Easy Access Sales Environment) is an interim interface for resale and UNE switch/port combinations. EDI stands for Electronic Data Interexchange.

53 *Investigation Concerning Illinois Bell Telephone Company's Compliance with Section 271(c) of the Telecommunications Act of 1996*, Illinois Commerce Commission, Order, August 13, 1997 at 77.

54 *In the Matter of the Application of Southwestern Bell Telephone Company Seeking Verification That It Has Fully Complied with and Satisfied the Requirements of SEC. 271(c) of the Telecommunications Act of 1996*, Arkansas Public Service Commission, Consultation Report of the Arkansas Public Service Commission to the Federal Communications Commission Pursuant to 47 U.S.C. §271(d)(2)(B), Citing Staff, Docket No. 98-408-U at 7, 11.

Ameritech's territories have not yet been sufficiently opened to enable competition to significantly diminish the incumbents' market power.

ii. CLECs Will Continue to Rely Upon ILEC Cooperation to Interconnect with ILEC Networks

53. Even if local service markets were fully opened to competition, the need for on-going regulation would not soon end. Because interconnection is required whenever multiple carriers provide service over disparate networks, entrants will continue to require high-quality and timely interconnection to the incumbent's public switched network. Adequate interconnection is vital to successful competition in telecommunications markets because acceptable telephone service presumes an ability to reach any subscriber on the public switched network.

54. In addition, because ILECs have clear incentives to deny competitors access, assuring adequate interconnection requires effective regulation. ILECs' incentives to deny access arise because telecommunications markets exhibit powerful network effects that can, if regulation is ineffective, be used to preserve a dominant provider's market position. Because the incumbent supplies access to virtually all existing network customers, it is not dependent upon interconnection with CLECs to complete calls. In contrast, it is unavoidable that entrants will initially have fewer subscribers than the incumbent and will therefore depend upon interconnection with the incumbent to complete most calls. If networks are not adequately interconnected, customers will prefer the incumbent's service, even if it is otherwise inferior to the entrant's, because they benefit from readily being able to make and receive calls on the public switched network. As the Commission has previously

stated, absent enforceable interconnection rules, incumbents could use their existing control over access to the subscriber base to suppress entry.[55]

55. While CLECs have no realistic alternatives to interconnection, they could potentially limit their dependence on the incumbent by investing in duplicate network facilities. But building network facilities is costly, time-consuming and, from the regulator's perspective, potentially wasteful. In addition, network facilities are largely sunk costs that increase the risk of entry for CLECs, raising an additional entry barrier. And because facilities represent fixed costs, they increase the market penetration needed to achieve profitability. For these reasons, investments in network facilities are unlikely to significantly diminish CLECs' dependence on interconnection in the near future.

V. THE MERGER ELIMINATES A SIGNIFICANT POTENTIAL ENTRANT INTO THE RESIDENTIAL AND SMALL BUSINESS MARKET IN ST. LOUIS

56. Ameritech began formal efforts to enter the St. Louis local exchange and access services market in May 1996. Through 1996 and 1997 Ameritech continued to press ahead with its entry plans, filing an amended application in August 1996 and subsequently negotiating an interconnection agreement with SBC in July 1997. The SBC-Ameritech interconnection agreement was initially filed with the Missouri PSC in August 1997, was refiled in November 1997, and was ultimately approved in

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55 "We are concerned that existing interconnection policies may not do enough to encourage the development of CMRS, especially in competition with LEC-provided wireline service. ...[I]t is important that the prices, terms, and conditions of interconnection arrangements not serve to buttress LEC market power against erosion by competition." *LEC-CMRS Interconnection Proceeding* at ¶2.

December 1997.[56] As recently as March 1998, Ameritech was reportedly beta testing its service and planned to commence a full market launch in July 1998.[57]

57. Ameritech's planned entry into St. Louis is especially noteworthy because, in contrast to most other well-capitalized potential entrants, Ameritech planned to initially target residential and small business customers. The Missouri PSC staff recommendation to the full Commission noted this initial focus on residential customers,[58] and SBC also acknowledges Ameritech's plans to target residential customers in its application.[59] Because it planned to target residential customers, Ameritech's entry into St. Louis could have generated substantial benefits for consumers.

58. Moreover, following the reasoning that the Commission laid out in the Bell Atlantic-Nynex merger, Ameritech plainly has competitive advantages over other potential entrants to the residential and small business segment of local services markets in St. Louis.[60] First, Ameritech has a well-known brand name from its position as the incumbent local exchange and access provider to 500,000 customers in East St. Louis and from its provision of cellular, alarm monitoring, wireless data

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56 *Order Approving Tariff*, Case No. TA-96-415 (Mo. PSC. Dec. 3, 1997).

57 Carolyn Hirschman, "Creatures: Competitive Local Exchange Carriers Evolve into Fierce Competitors as the 1996 Telecom Act Starts to Empower the Little Guys," *Telephony*, March 16, 1998. The *New York Times* reported that merger discussions also began in early March 1998. Laura M. Holson, "Telephone Giant: The Genesis," *The New York Times*, May 12, 1998 at D11.

58 Staff's Recommendation to Approve Basic Local Exchange Tariff, Case No. TA-96-415, File No. 9800345 (Mo. PSC. Nov. 19, 1997).

59 *Merger Application* at 72.

60 *Bell Atlantic-Nynex Order* at ¶62.

and paging services in St. Louis proper.[61] The BOCs, including Ameritech, have made strong claims about the importance of brand names in interexchange markets.[62] There is every reason to believe that the competitive advantages of a strong brand name are at least as important in residential local exchange and access markets as in long distance markets.[63] Second, Ameritech is an experienced local service provider with telecommunications facilities located in and around St. Louis. Third, Ameritech is familiar with the St. Louis local service market because it already provides several telecommunications services in the metropolitan area. This familiarity should aid Ameritech's efforts to create attractive packages of local telephone services. Fourth, Ameritech's existing customer base in St. Louis should reduce the company's customer acquisition costs. These advantages leave Ameritech especially well-positioned to successfully enter local service markets in St. Louis. Indeed, Ameritech officials have claimed that "St. Louis is a natural extension of our current geography."[64]

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61 John Van, "St. Louis Landing for Ameritech: A Spirited Challenge to Rival Baby Bell's Monopoly," *Chicago Tribune*, November 7, 1997 at 1, and *Communications Daily*, "Ameritech Becomes First RHC to Apply for Full Service Outside Region," November 7, 1997.

62 *In the Matter of Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana*, CC Docket No. 98-121, Declaration on Behalf of BellSouth by Richard S. Schmalensee, July 9, 1998 at Section VI. See also *In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan*, CC Docket No. 97-137, Affidavit of Paul W. MacAvoy in Support of the Application of Ameritech Michigan for Provision of In-region InterLATA Long Distance Services in Michigan, March 1997 at ¶85 and Joint Affidavit of Richard J. Gilbert and John C. Panzar on behalf of Ameritech Michigan, May 1997 at ¶19.

63 The Commission noted the importance of brand name recognition for attracting mass market customers in the *Bell Atlantic-Nynex Order* at ¶¶6, 20, and 42.

64 Thomas E. Richards, executive vice president, as quoted in the *St. Louis Post-Dispatch*. Jerri Stroud, "Ameritech May Enter St. Louis Phone Market," *St. Louis Post-Dispatch*, November 7, 1997.

59. In their application to the Commission, SBC and Ameritech claim that Ameritech was reassessing its entry plans because there is too much competition in local exchange and access markets in St. Louis to provide service at a profit. This claim stands in sharp contrast to Ameritech's pre-merger public statements that St. Louis is a good market to enter because residential markets there are "widely ignored" by competitors.[65] There is no evidence that competition for residential and small business customers has increased since Ameritech first announced plans to enter St. Louis.

60. Ameritech is the first BOC to enter an out-of-region local exchange and access services market. Before the merger, Ameritech had applied to enter additional out-of-region markets.[66] It is not in the public interest to allow SBC to end this nascent threat to its monopoly over local exchange and access services in St. Louis by merging with Ameritech.

VI. CONCLUSION

61. SBC and Ameritech possess substantial market power in local exchange and access services markets. That market power largely stems from control of access to customers: SBC and Ameritech each serve a dominant share of switched access lines in their service regions, and local service competitors require their cooperation to

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65 *Communications Daily*, "Ameritech Becomes First RHC to Apply for Full Service Outside Region," November 7, 1997.

66 See *Application of Ameritech Communications International, Inc. for a Service Provider Certificate of Operating Authority,* Texas PUC Docket No. 16965, Order (Apr. 2, 1997); *Application of Ameritech Communications International, Inc. and Southwestern Bell Telephone Company for Approval of Interconnection Agreement Under PURA and the Telecommunications Act of 1996,* Texas PUC Docket. No. 17782, Order (Nov. 6, 1997); *Application of Ameritech Communications International, Inc. for a certificate of Public Convenience and Necessity to Offer Local Telecommunications Service to the Public in the State of California,* California PUC Decision 97-06-087, Opinion (June 25, 1997); *Request for Approval of Interconnection Agreement Between Pacific Bell and Ameritech*

complete calls on SBC's and Ameritech's local networks. Absent high-quality and timely interconnection, competitors will be unable to offer a viable service alternative.

62. In addition, entry is unlikely to significantly diminish the market power possessed by SBC and Ameritech for years to come. First, the proposed merger eliminates a significant potential entrant into each service region. Second, as the Commission and several state commissions have consistently found, local markets in the states served by SBC and Ameritech are not yet sufficiently open to enable competition to thrive. Furthermore, SBC and Ameritech control the pace at which their markets are opened to competitors because they control access to those customers.

63. Even if markets were fully opened to competition, the need for regulatory oversight of SBC and Ameritech would not soon end. Interconnection is required whenever multiple carriers provide service over disparate networks. Because incumbent local exchange carriers have clear incentives to deny competitors access, assuring adequate interconnection requires effective regulation.

64. This merger does not satisfy the Commission's public interest standard because it preserves the dominant market positions of SBC and Ameritech and it fails to materially improve the prospects for competition in any relevant market.[67]

Communications International, Inc. Pursuant to Section 252 of the Telecommunications Act of 1996, California PUC Resolution T-16131 (March 12, 1998).

[67] *Bell Atlantic-Nynex Order* at ¶36.

APPENDIX A

Curriculum Vita for Dr. John B. Hayes

The Tilden Group, LLC
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Education

University of Wisconsin, Madison, WI
Doctor of Philosophy in Economics, 1994

University of Denver, Denver, CO
Master of Arts in Economics, 1986

Stanford University, Palo Alto, CA
Bachelor of Arts in Economics, Stanford University, 1983

Awards

1992 Federal Reserve System Board of Governors Dissertation Fellowship
1986 University of Denver Fellowship

Current Position

Senior Economist, **The Tilden Group,** Oakland CA
September 1997 - present
Economic analysis to support antitrust litigation in high technology and communications industries.

Professional Experience

Economist, **U.S. Department of Justice, Antitrust Division,** Washington, D.C.
1993 - 1997
Economic analysis to support antitrust litigation and Federal competition policy. Advised and trained foreign competition agency personnel. Extensive telecommunications experience includes comments filed with the Federal Communications Commission and analysis of the AT&T-McCaw and Bell Atlantic-Nynex cellular mergers.

Adjunct Professor of Economics, **Georgetown University,** Washington D.C.
1995 - 1996
Taught an undergraduate course in industrial organization.

Research Assistant, **Wisconsin Vocational, Technical and Adult Education System**, Madison, WI
1989 - 1991
Economic analysis of labor market trends affecting enrollment in the VTAE system.

Project Manager, **US WEST, Strategic Marketing Division**, Denver, CO
1987 - 1988
Identified new business opportunities. Compared the performance of business units to industry benchmarks. Trained staff in the use of data resources for business performance analysis.

Research Assistant, **Medical Group Management Association, Center for Research and Ambulatory Health Care**, Denver, CO
1986 - 1987
Survey design, implementation, analysis, and presentation of results. Authored articles for the association newsletter and journal. Maintained research databases. Prepared research proposals.

Research Papers

1994 Hayes, John B. "Do Firms Play Exit Games? Theory and Evidence on the Strategic Role of Size in an Exit Game." Ph.D. dissertation, Department of Economics, University of Wisconsin-Madison.

1994 Hayes, John B. "An Exit Game with Continuously Adjustable Output and Efficiency Differences." Working paper, Department of Economics, University of Wisconsin-Madison.

1993 Hayes, John B. "Do Firms Play Exit Games? Some Evidence on the Strategic Liability of Size." Working paper, Department of Economics, University of Wisconsin-Madison.

1992 Eisner, James and John B. Hayes. "Labor Market Information for the Trade and Industry Occupations." Wisconsin Board of Vocational, Technical and Adult Education, Madison, WI.

1990 Hayes, John B., Catherine M. Cotter, and Ronald J. Hustedde. "Labor Market Information for Business and Marketing Occupations." Wisconsin Board of Vocational, Technical and Adult Education, Madison, WI.

1990 Hayes, John B. "Optimal Exit Strategy in a Stochastically Declining Market." Applied Microeconomics Workshop, Department of Economics, University of Wisconsin-Madison.

APPENDIX B

Data Sources for Tables 1 and 3

Resold residential and business lines, for both ILECs and CLECs, were reported by SBC and Ameritech in the *Local Competition Survey*. CLEC purchases of unbundled loops were also reported in the *Local Competition Survey*. These loop counts did not distinguish between residential and business loops. Using Brooks Fiber's experience in Michigan, as reported in the *Harris-Teece Michigan Affidavit*,[68] as well as Brooks Fiber's report to the Michigan PSC that 90 percent of its residential customers are on unbundled loops and 10 percent of its residential customers are on fully facilities-based lines, I estimated that 46.25 percent of the unbundled loops reported for SBC and Ameritech in the *Local Competition Survey* serve residential customers. This estimate probably overstates the fraction of unbundled loops serving residential customers, as Brooks Fiber targeted residential customers in Michigan more aggressively than did CLECs in other locations. The estimate of fully facilities-based (on-network) CLEC lines is derived from information provided by ILECs in the following 271 proceedings:

- Consultation Report of the Arkansas Public Service Commission, *In the Matter of the Application of SBC Seeking Verification That It Has Fully Complied With and Satisfied the Requirements of Sec. 271(c)*, Docket No. 98-048-U ("*Arkansas PSC Consultation Report*");
- Draft Brief in Support of Application by SBC for Provision of In-Region, InterLATA Services in California, Submitted to CPUC, March 31, 1998 ("*Draft California 271 Application*");
- *Harris-Teece Michigan Affidavit*;

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[68] *In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan*, Joint Affidavit of Robert G. Harris and David J. Teece On Behalf of Ameritech Michigan, CC Docket 97-137 ("*Harris-Teece Michigan Affidavit*").

- Affidavit of Carl Shapiro on Behalf of Sprint, *In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan*, CC Docket 97-137; and
- Brief in Support of Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Long Distance for Provision of In-Region, Interlata Services in Oklahoma, *In the Matter of Application of SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Oklahoma*, CC Docket No. 97-121, filed April 11, 1997.

The number of on-network CLEC lines that serve residential and business customers in California, Michigan and Oklahoma was estimated using information provided by SBC to the California PUC regarding the proportion of on-network residential and business lines in California as of March 1998.[69] This information indicated that 1.07 percent of on-network CLEC lines serve residential customers. Because data specific to Arkansas were also available, the number of on-network CLEC lines serving residential and business customers in Arkansas was estimated using information contained in the *Arkansas PSC Consultation Report.*[70] The Arkansas data indicated that 1.02 percent of on-network CLEC lines serve residential customers (although all of the on-network residential lines in Arkansas, according to the Consultation Report, serve a single CLEC's employees on a trial basis).

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69 *Draft California 271 Application.*

70 *Arkansas PSC Consultation Report.*